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IN THE

Supreme Court of the United States

October Term, 1970

No. 1493

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,
Petitioners,

against

PAUL BENJAMIN,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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April 19, 1971

TABLE OF CONTENTS

	PAGE
Counterstatement of Questions Presented	1
Statement of the Case	2
Reasons for Not Granting the Writ	9
I. The Decision Below on the "Aiding Jurisdiction" Exception to the Anti-Injunction Statute Is Clearly Correct	9
II. There Is No Conflict of Decision on the "Aiding Jurisdiction" Exception	12
III. The Decision Below on the "Act of Congress" Exception to the Anti-Injunction Statute Is Clearly Correct	14
IV. The Petition Is Moot	16
Conclusion	17
Appendix	
Statute	18

TABLE OF AUTHORITIES

Cases:

Abramson v. Pennwood Investment Corp., 392 F.2d 759 (2d Cir. 1968)	9
Atlantic Coast Line Railroad Company v. Brotherhood of Locomotive Engineers, 398 U.S. 281 (1970)	13
Brownlow v. Schwartz, 261 U.S. 216 (1923)	16
Doyne v. Saettele, 112 F.2d 155 (8th Cir. 1940)	14

PAGE

Essex Systems Company, Inc. v. Abraham Steinberg, 70 Civ. 4595 (S.D.N.Y., Dec. 17, 1970) (opinion as yet unreported) 12

Greater Continental Corp. v. Schechter, 304 F.Supp. 325 (S.D.N.Y. 1969), *appeal dismissed,* 422 F.2d 1100 (2d Cir. 1970) 10

Hyde Construction Co. v. Koehring Co., 388 F.2d 501 (10th Cir. 1968), *cert. denied,* 391 U.S. 905 (1968) 14

J. I. Case Co. v. Borak, 377 U.S. 426 (1964) 15

Klein v. Walston, 432 F.2d 936 (2d Cir. 1970) 9, 11

Lyons v. Westinghouse Electric Corp., 201 F.2d 510 (2d Cir. 1953), *cert. denied,* 345 U.S. 923 (1953) 10

Red Rock Cola Co. v. Red Rock Bottlers, Inc., 195 F.2d 406 (5th Cir. 1952) 10, 12

Studebaker Corporation v. Gittlin, 360 F.2d 692 (2d Cir. 1966) 15

Wisniewski v. United States, 353 U.S. 901 (1957) 16

Statutes and Rules:

15 U.S.C. §78bb (Section 28(a) of the Securities Exchange Act of 1934) 9
15 U.S.C. §78j(b) (Section 10(b) of the Securities Exchange Act of 1934) 4, 10
15 U.S.C. §78u(e) (Section 21(e) of the Securities Exchange Act of 1934) 2, 15
15 U.S.C. §78n(a) (Section 14(a) of the Securities Exchange Act of 1934) 15
28 U.S.C. §2283 ..... 2, 6, 10
Rule 19(1)(b), Supreme Court Rules 12

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BRIEF FOR RESPONDENT IN OPPOSITION

Respondent respectfully prays that the Petition for a Writ of Certiorari to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered herein on March 5, 1971, be denied.

Counterstatement of Questions Presented

1. Whether the collateral estoppel effects of a state court judgment are such an interference with a federal court's exclusive jurisdiction over claims under the Securities Exchange Act of 1934 so as to bring a federal injunc-

tion against state court proceedings within an exception to the anti-injunction statute, 28 U.S.C. §2283, as being necessary in aid of the federal court's jurisdiction?

2. Whether §21(e) of the Securities Exchange Act of 1934, 15 U.S.C. §78u(e), is an Act of Congress, within the meaning of 28 U.S.C. §2283, expressly authorizing an entity other than the Securities Exchange Commission to enjoin state proceedings which do not themselves violate the Securities Exchange Act of 1934?

3. Whether the Petition has became moot by the vacation of the preliminary injunction issued by the District Court and subsequent entry of judgment in favor of respondent in the Supreme Court of the State of New York?

Statement of the Case

On December 28, 1967 respondent Paul Benjamin ("Benjamin"), by written agreement, sold his family business, American Medical Instrument Corporation, to the New York corporate predecessor of petitioner Vernitron Corporation ("Vernitron") and to its wholly-owned subsidiary, which then changed its name to American Medical Instrument Corporation ("Amico") and is now the other petitioner in this action (31-32).* Benjamin is presently 73 years old and is living in retirement in Florida.

Under the written agremeent, Benjamin was to receive $1,500,000 worth of Vernitron common stock which was to

* Unless otherwise designated, all references are to page numbers of respondent's Appendix filed with the United States Court of Appeals for the Second Circuit.

be placed in escrow with Vernitron's attorneys as escrow agents. After certain time periods, the agreement provided that Vernitron must register certain portions of the escrowed common stock at Benjamin's request so that it could be sold on his behalf. On February 1, 1969, pursuant to the agreement, Benjamin requested registration of all the common stock remaining in escrow, having a value of approximately $1,051,000. Under the agreement, Vernitron had five months within which to make a registration statement effective (32-34).

Vernitron concededly refused to include these remaining escrowed shares in a registration statement (20, 175), although it did file a registration statement with respect to other shares in August 1969 (36). In October 1969, the agreement required Vernitron and its law firm as escrow agents to deliver to Benjamin enough unregistered shares, whether in escrow or not, to make up the $1,051,000 balance of the purchase price. Vernitron and its law firm admittedly refused to deliver these shares to Benjamin after due demand had been made (35, 50-1, 95, 122, 135).

Consequently, on November 6, 1969, Benjamin instituted suit against Vernitron, Amico, and their law firm in the Supreme Court of the State of New York claiming breach of contract for failure to register the shares and for failure to make delivery of unregistered shares in October and claiming that Vernitron and Amico induced their law firm to breach the escrow agreement (105-114). Vernitron and Amico answered on December 31, 1969, asserting counterclaims for the alleged breach of eight warranties in the acquisition contract and asking damages or rescission (115-132). Only about $34,000 in actual damages were alleged,

as compared to Benjamin's claim in his first cause of action alone for about $1,051,000. Vernitron and Amico claimed additional as yet undetermined amounts of damages, although two years had elapsed since the closing date of the acquisition agreement. Benjamin denied all allegations of breach (138-140).

Discovery in the spring of 1970 indicated Vernitron's counterclaims to be worth no more than about $43,000 (150-171). Therefore, on June 2, 1970, Benjamin moved for summary judgment on his first cause of action against Vernitron for failure to register the shares. New York practice permits summary judgment to be awarded a plaintiff on his claim where there are no issues of fact, even in the face of counterclaims having issues of fact to be tried; however, the usual practice is to grant partial summary judgment to a plaintiff, severing that part of his claim as is deemed necessary to secure a defendant in the trial of his counterclaims. Benjamin did not move for summary judgment on any part of the counterclaims.

Vernitron and Amico's response to Benjamin's motion for summary judgment was suddenly to decide that their rights needed protection in federal court, although for six months they had been content with their counterclaims in state court. On June 16, 1970, three days before the adjourned return date of Benjamin's summary judgment motion, Vernitron and Amico instituted this action in the United States District Court for the Southern District of New York, setting forth the same allegations of fact set forth in their state counterclaims, but predicating their rights on the Securities Exchange Act of 1934, §10(b) (1-14). However, their damages were alleged to be of the

same approximate value as the damages Benjamin was seeking because it was claimed for the first time that they had arrived at a purchase price for Benjamin's company by employing a multiple-of-earnings formula, and that, therefore, their damages, which allegedly affected earnings in 1967, should be multiplied by the same multiple. Together with the institution of this suit, Vernitron and Amico sought a temporary restraining order and a preliminary injunction against Benjamin's prosecution of the state action.

After hearing argument and receiving briefs, U. S. District Judge Morris E. Lasker denied the application for a temporary restraining order, and argument of Benjamin's motion for summary judgment in the state action went ahead on June 19, 1970. On June 24, 1970 the motion for a preliminary injunction was argued before Judge Lasker who reserved decision. While this latter motion was *sub judice,* Justice Nathaniel T. Helman of the Supreme Court of the State of New York, by decision dated July 16, 1970, granted Benjamin partial summary judgment in the amount of $1,008,598.27 (212-18). This sum was arrived at by determining the maximum alleged value of Vernitron's counterclaims to be approximately $43,000 and subtracting this latter sum from the amount claimed by Benjamin in his first cause of action.

Justice Helman granted no summary relief on the counterclaims, but he did discount Vernitron's newly raised contention that a multiple-of-earnings formula was used to determine the purchase price of the acquisition and that, consequently, counterclaim damages should be multiplied by some number, alleged by Vernitron to be ten at some

times and to be some unspecified figure—other than ten—at others. Justice Helman noted that there was no mention of any such formula in the acquisition agreement (216-18).

Before Benjamin could enter an order and judgment upon Justice Helman's decision (Benjamin waited at the request of Judge Lasker), the District Court on July 27, 1970, granted petitioners' motion for a preliminary injunction and stayed respondent and his attorneys from continuing the prosecution of the state court action pending the disposition of the federal proceedings. After receiving information from Benjamin indicating that Vernitron's net income had fallen from over $4,000,000 to approximately $120,000 from the year ended December 28, 1968 to the year ended December 27, 1969, Judge Lasker required petitioners to post a bond in the full amount of Benjamin's award of summary judgment in the state action (250-1, 264). Benjamin promptly appealed from Judge Lasker's order of injunction.

Judge Lasker reasoned that an injunction against the state court proceedings was within an exception to the anti-injunction statute, 28 U.S.C. §2283, as necessary in aid of the federal court's exclusive jurisdiction over matters arising under the Securities Exchange Act of 1934. Judge Lasker seemed primarily concerned that a judgment in the state action on Benjamin's first cause of action would bar petitioners from establishing, if they could, their multiple-of-earnings theory of damages in federal court (Petition, p. 12a).

Benjamin appealed from Judge Lasker's order primarily on three grounds. He contended that the injunction

was not necessary in aid of exclusive federal jurisdiction over a Securities Exchange Act claim because fact-finding in a state court could not impair federal *jurisdiction,* but simply left fewer issues to be tried in the federal action. He also contended that Justice Helman in granting summary judgment only on Benjamin's first cause of action, and not on the counterclaims, decided no issues of fact (other than the undisputed non-registration of the shares) which would have a collateral estoppel effect on federal claims in federal court, and that Vernitron and Amico could prevent future fact-finding in the state action by simply not prosecuting their counterclaims therein. Finally, Benjamin contended that Judge Lasker had abused his discretion in finding sufficient merit in petitioners' claims to justify a grant of a preliminary injunction.

On March 5, 1971, the Second Circuit reversed Judge Lasker's order of preliminary injunction and remanded the case to the District Court. The Court of Appeals stated (Petition, pp. 4a-5a):

> "There can be no question but that the doctrine of collateral estoppel would be applied in any instance where the state court had determined a factual issue arising in a subsequent federal litigation. * * * But, to justify an injunction of a state court action, '[i]t is not sufficient to show that the matter properly before a state court embraces issues within the compass of the federal suit, even if the federal court has exclusive jurisdiction over its case'. * * * There is no reason why the state court cannot or should not determine issues of fact and state law relevant thereto as they come up in the state litigation. The subsequent effect of collateral estoppel, far from requiring the federal court to stay proceedings in the state court, is a result which

should be welcomed to avoid the task of reconsidering issues which have already been settled by another competent tribunal."

Benjamin promptly made a motion to shorten the time for issuance of the mandate of the Second Circuit. Vernitron and Amico opposed this motion on the ground that they would petition for certiorari within the normal 21-day stay of the mandate. On March 17, 1971, the Second Circuit granted Benjamin's motion and provided that the mandate should issue immediately. The District Court received the mandate on March 19, 1971, and immediately vacated its preliminary injunction. Immediately thereafter, Benjamin served notice upon petitioners of the settlement of an order in the state court on March 23, 1971 in accordance with the grant of partial summary judgment. On March 20, 1971, Vernitron and Amico filed this Petition, at the same time seeking a stay of the vacation of the preliminary injunction by motion to Justice Harlan. The stay was denied on March 22, 1971.

Vernitron and Amico then immediately moved in the state action for a "renewal or rehearing" of Benjamin's motion for summary judgment, claiming the discovery of new evidence increasing the size of their claims since the original state decision in July 1970. This motion was argued on March 31, 1971 before Justice Helman who temporarily refrained from signing Benjamin's proposed order. On April 6, 1971, Justice Helman denied the motion for rehearing and signed Benjamin's order granting him partial summary judgment in an amount of $1,008,598.27 plus interest and costs. On April 8, 1971, a judgment was entered in accordance with this order.

Reasons for Not Granting the Writ

I. The Decision Below on the "Aiding Jurisdiction" Exception to the Anti-Injunction Statute Is Clearly Correct.

Petitioners are attempting to parlay a 10-month-old federal litigation initiated solely to block entry of summary judgment for Benjamin in state court into a case raising "significant questions involving the enforcement and interpretation of the exclusive federal securities laws rights and remedies * * *" (Petition, p. 7). Indeed, if petitioners' completely unsupported view of the law prevailed, the results would no doubt be "significant" in the sense of having a catastrophic effect on federal-state relationships. A preemptive federal jurisdiction would be created in the fraud-in-securities-transactions field which would bar state court litigation of purely state claims, as long as facts might be tried in such state court litigation which would be relevant to a Securities Exchange Act claim. This would seem contrary to the Act itself, which provides at 15 U.S.C. §78bb:

> "(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or at equity. * * *"

There is *no* case law support for the unique position petitioners advocate that state court fact-finding may be prevented by a federal injunction where the facts might have some relevance to an action under the Securities Exchange Act in federal court. Indeed, the only cases either squarely hold, or directly imply, the contrary. *Klein* v. *Walston,* 432 F.2d 936 (2d Cir. 1970); *Abramson* v. *Pennwood Invest-*

ment Corp., 392 F.2d 759, 762 (2d Cir. 1968); *Lyons* v. *Westinghouse*, 201 F.2d 510 (2d Cir. 1953), *cert. denied*, 345 U.S. 923 (1953); *Red Rock Cola Co.* v. *Red Rock Bottlers, Inc.*, 195 F.2d 406 (5th Cir. 1952); *Greater Continental Corp.* v. *Schechter*, 304 F. Supp. 325 (S.D.N.Y. 1969), *appeal dismissed*, 422 F.2d 1100 (2d Cir. 1970).

The last of these cases is remarkably similar to the instant case. Judge Marvin Frankel held that the anti-injunction statute barred preliminary injunctive relief against a state action. Schechter had sold his company to Continental receiving in return shares of Continental stock to be held in escrow for two years by Continental's attorneys (as here). Continental then supposedly discovered that Schechter had breached warranties and representations and did not pay Schechter a substantial part of the consideration. Schechter brought suit in the Supreme Court of the State of New York, New York County, seeking cash and the 100,000 Continental shares being held in escrow. At about the same time (here, Vernitron waited over seven months until a summary judgment motion was pending), Continental sued Schechter in federal court under the Securities Exchange Act of 1934, §10(b), claiming securities fraud in the breach of these representations.

Continental moved in the federal action for a preliminary injunction to stay further prosecution of the suit in the state court. Judge Frankel held that 28 U.S.C. §2283 barred a preliminary injunction issuing against prosecution of the action in New York Supreme Court. He held that it was "not sufficient to show that the matter properly before a state court embraces issues within the compass of the federal suit, even if the federal court has exclusive jurisdiction over its case" (*id.* at 330).

Although the quoted portion of Judge Frankel's opinion does not refer to the doctrine of collateral estoppel in so many words, it clearly rejects the theory that state trial of issues of fact with a consequent collateral estoppel effect can interfere with exclusive federal jurisdiction over a Securities Exchange Act claim. This is so because he found nothing wrong with a state trial of matter which "embraces issues within the compass of the federal suit" even though such a trial would necessarily involve a collateral estoppel effect in federal court.

The same result was reached by the Second Circuit by implication in *Klein* v. *Walston, supra.* There, the Second Circuit affirmed an order of the District Court staying proceedings under the Securities Exchange Act of 1934 in that court pending final determination of a prior state action based upon common law contract and fraud claims arising out of the same facts. The Second Circuit, 432 F.2d at 937, *supra,* stated:

> "While because of the exclusive jurisdiction of the federal courts to enforce the Securities Exchange Act of 1934, §27, the state court will not be able to determine certain claims asserted in the federal suit but not advanced in the state action, it can authoritatively determine the common law claims. * * *"

Yet a state determination of the common law claims would clearly involve state findings of fact having a collateral estoppel effect in the federal action. The Second Circuit was obviously aware that such a result would not interfere in any way with the District Court's exclusive jurisdiction over claims under the Securities Exchange Act of 1934.

And the District Court for the Southern District of New York has read the *Klein* decision in this manner. In *Essex Systems Company, Inc.* v. *Abramham Steinberg*, 70 Civ. 4595 (S.D.N.Y., Dec. 17, 1970) (opinion as yet unreported), Judge Croake refused to enjoin a state court proceeding in New Jersey in a situation almost identical to the situation in the case at bar. Judge Croake rested his decision in part on the *Klein* case, saying "[t]he *Klein* class mandates the conclusion that collateral estoppel of independent proof of part or even all the facts is not such a jurisdictional impairment as to allow an injunction 'in aid of jurisdiction' " (Opinion, p. 9).

II. There Is No Conflict of Decision on the "Aiding Jurisdiction" Exception.

And what do petitioners present in the face of this overwhelming, recent line of authority? They do not cite one single case from any jurisdiction anywhere in the United States (other than the opinion of the District Court below) which supports their novel position that the collateral estoppel effect of state court fact-finding can interfere with exclusive federal jurisdiction over a Securities Exchange Act claim so as to justify a federal injunction against the state court proceeding. Thus, not only is there no conflict of decision within the Second Circuit, but there is no conflict between the decisions of the various courts of appeals within the meaning of Rule 19(1)(b) of the Supreme Court Rules. Indeed, in the only case we have found on point from a circuit other than the Second Circuit, the Fifth Circuit has held in accord with the rule in the Second Circuit, *Red Rock Cola Co.* v. *Red Rock Bottlers, Inc., supra.*

Three of the cases relied upon by Vernitron and Amico at page 8 of the Petition do in fact come from circuits other than the Second Circuit, but these cases, as do the other cases cited by petitioners on page 8 of the Petition, simply hold that state court fact-finding does have a collateral estoppel or *res judicata* effect in a federal Securities Exchange Act litigation. There is no suggestion in any of these cases that the prior state court actions had improperly invaded the federal courts' jurisdiction or that the operation of these doctrines interfered in any way with the federal court's exclusive jurisdiction over claims under the Securities Exchange Act. There is no intimation that an injunction should have issued to block these respective state courts from trying these cases. There is no expression of helplessness at being in a position where the federal action must be dismissed because of the state adjudications.

In fact, in their entire Petition the only pretension Vernitron and Amico make of putting forth a ground for granting a Writ of Certiorari is in their statement that the decision of the Second Circuit is in conflict with this Court's recent decision in *Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers,* 398 U.S. 281 (1970). But in the cited case this Court *reversed* the award of an injunction against the state proceeding. In addition, the federal injunction sought was against enforcement of a state injunction *already in existence,* and consequently the problem of state court fact-finding having a collateral estoppel effect in federal court did not exist at all. Petitioners' only recourse is to attempt to derive support from the general language of this Court's opinion concerning the anti-injunction statute (Petition, p. 11). However, the language quoted, if anything, secures respondent in his posi-

tion. For this Court stated (*id.* at 295) that the "aiding jurisdiction" exception to the anti-injunction statute "implies something similar to the concept of injunctions to 'protect or effectuate' judgments." Federal injunctive relief must be necessary "to prevent a state court from so interfering with a federal court's consideration or disposition of a case as to seriously impair the federal court's flexibility and authority to decide that case."

It is clear what is meant by this language. The state court must be actually attempting in some way to interfere with the federal court's *jurisdiction.* Thus, the classic case occurs when a state court attempts to assume jurisdiction over a *res,* over which a federal court has acquired prior jurisdiction. To allow the state court to assume jurisdiction over the same *res* would be to remove the federal court's entire basis for proceeding in the action. *Hyde Construction Co.* v. *Koehring Co.,* 388 F. 2d 501 (10th Cir. 1968), *cert. denied,* 391 U.S. 905 (1968); *Doyne* v. *Saettele,* 112 F. 2d 155 (8th Cir. 1940). As the Second Circuit noted below, decision of facts by a state court does not interfere with federal *jurisdiction* but "is a result which should be welcomed to avoid the task of reconsidering issues which have already been settled by another competent tribunal" (Petition, p. 5a).

III. The Decision Below on the "Act of Congress" Exception to the Anti-Injunction Statute Is Clearly Correct.

As a second prong in their Petition for a Writ of Certiorari, Vernitron and Amico argue that the injunction in the District Court came within the "Act of Congress" exception to the anti-injunction statute (Petition, pp. 12, 20a).

Petitioners place their sole reliance on *Studebaker Corporation* v. *Gittlin*, 360 F.2d 692 (2d Cir. 1966). Yet in that case, the injunction was sought against state proceedings which would *themselves* have violated the Proxy Rules issued by the SEC under §14(a) of Securities Exchange Act. In state court, Gittlin sought the use of other stockholders' authorizations to obtain inspection of Studebaker's shareholders' list. Studebaker claimed Gittlin had obtained these authorizations without filing the proxy material required by the Proxy Rules under §14(a).

The Second Circuit held that the policy of the anti-injunction statute was "superseded by the need for an immediate and effective enforcement of federal securities regulations and statutes" (*id.* at 698), and this brought a private party within the "Act of Congress" exception.* However, the need for immediate and effective enforcement was occasioned by Gittlin's attempted use of the illegal authorizations in state court. If Gittlin had been allowed to use the allegedly invalid stockholders' authorizations in the New York court proceedings to obtain an inspection of the Studebaker shareholders' list, a later finding in federal court that these authorizations had been obtained in violation of the Proxy Rules issued by the SEC would have been without any force since the damage would have been complete. The shareholders' list would have been obtained and inspected. The federal plaintiffs in that case, therefore, were acting as private parties to *enforce* the federal securities laws. Benjamin was making no attempt in his

* §21(e) of the Securities Exchange Act of 1934 expressly permits the SEC to bring an action to enjoin violations of the Act, and the Second Circuit held a private party also authorized to seek an injunction under the principles of *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964).

state court action to violate the federal securities laws. His claim is simply one for breach of contract. The issue of immediate and effective enforcement of the federal securities laws is not involved at all. Both Judge Lasker (Petition, p. 11a) and the Second Circuit (Petition, p. 5a) agreed with this interpretation of the *Studebaker* case.

However, even if the opinion below of the Second Circuit can be read to have "improperly circumscribed the holding" in the *Studebaker* case, then petitioners are still not entitled to a Writ. For *both* the opinion below and the *Studebaker* case involved decisions of the Second Circuit, and, if anything, the opinion below, as the later decision, is controlling and there is no conflict. In such a case, issuance of a Writ of Certiorari is not appropriate since the Second Circuit may reconcile its own internal difficulties by development of its case law. See *Wisniewski* v. *United States,* 353 U.S. 901 (1957).

IV. The Petition Is Moot.

Finally, and perhaps most important of all, a Writ of Certiorari should not be granted because the question of the propriety of a preliminary injunction against the state action has been mooted by the vacation of the preliminary injunction and the entry of judgment in the state court. Petitioners' only fear has been that the entry of a judgment would result in a collateral estoppel or *res judicata* effect in their federal proceeding. If they are right, then the damage has irretrievably occurred because judgment has been entered. See *Brownlow* v. *Schwartz,* 261 U.S. 216 (1923). Whether any further "damage" can occur to petitioners by reason of *another* judgment resulting from

the trial of their counterclaims in the state action is entirely up to petitioners, since they are free to choose not to prosecute their counterclaims in the state action (by voluntary dismissal or inaction) and to proceed instead in federal court, as they have consistently claimed they desire to do.

Conclusion

For the reasons set forth above, petitioners should be denied a Writ of Certiorari to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

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APPENDIX

Statute

15 U.S.C. §78bb:

"(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder."